Adequate organizational, administrative, and accounting governance structures: the new features of the Crisis Code and the implications for directors' liability and bank relations

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CORPORATE AND COMMERCIAL; CAPITAL MARKETS
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Paolo Barbanti Silva
Enzo Fanelli

Introduction

With the introduction, in 2019, of the Italian Crisis and Insolvency Code ("**CCII**"), entrepreneurs, both collective and individual, are now required to establish an organizational, administrative, and accounting structure that is appropriate to the nature and size of the business "*also in function of the timely detection of the business crisis and the loss of business continuity*" in order to " *promptly adopt and implement one of the tools provided by the law to overcome the crisis and restore business continuity*". Although Article 2381 of the Italian Civil Code already mandated directors to establish an adequate organizational, administrative, and accounting governance structure, from 2019 onwards, entrepreneurs must comply with an enhanced formulation of these obligations. The so-called "adequate organizational structures" (hereafter also referred to as "**Adequate Structures**") are now also significant for the early detection of signs of economic/financial imbalance within the business.

It is therefore essential for businesses of all sizes —small, medium, and large— to adopt, in accordance with the CCII (Article 3) and the new text of Article 2086 of the Civil Code, Adequate Structures that can promptly record any patrimonial and/or economic-financial imbalances and verify the sustainability of indebtedness within a twelve-month period.

Given the inability to address all issues related to Structures in this context, which would require a much longer discussion, today's analysis will be limited to the main consequences of non-compliance with this duty, both in relation to bank-business relationships and in assessing the liability of those acting as company directors.

What is meant by "Adequate Organizational Structures"

As previously mentioned, the legislator has supplemented the general obligation of organization for entrepreneurs with the duty to establish Adequate Structures to promptly detect any signs of crisis and loss of business continuity. The aim is to identify the most suitable path for business recovery and avoid liquidation.

However, aside from specifying that these structures must be adequate in relation to the nature and size of the business, the law does not provide further details on the characteristics that such Adequate Structures should possess, leading to several interpretative doubts. It is indeed challenging, from a legal standpoint, to precisely determine when a structure can be considered "adequate", given the difficulty in abstractly defining a model that could be efficient for all businesses.

In this perspective, the doctrine agrees that a key principle to consider is proportionality, even though this is not explicitly mentioned in the provisions of the CCII. It is undeniable that the concrete and correct modulation of an Adequate Structure cannot ignore the size of the business, its area of operation, its degree of development, and its financial/accounting situation.

In European Union law (Article 5, paragraph 4 of the Treaty on European Union, 2012), a rule is considered to achieve the principle of proportionality when it is (i) suitable/necessary to achieve the desired goal, and (ii) does not impose an excessive burden on the agent compared to the objective to be achieved.

Given this premise, the practical preparation and implementation of Adequate Structures, also in light of the most recent jurisprudence and the guidelines provided by the Italian National Research Foundation of Chartered Accountants, should be characterised by the following elements:

i. a grid of KPIs (*Key Performance Indicators*), for economic, financial, and asset management to anticipate the signs of a potential state of crisis;

ii. a short and medium to long-term industrial and strategic plan;

iii. an updated organizational chart and functional chart that accurately represent the business reality, including the structure of delegations and the assignment of powers for top managerial roles;

iv. a comprehensive set of reports from the administrative body on the management performance and its foreseeable evolution;

v. the formulation of forecasts regarding the ability to meet significant payment obligations, and, where necessary, outlining in advance the actions to be taken in case of events that could compromise business continuity (e.g., top management succession plan); and

vi. reports by the administrative body on new investments, which should not only compare the progress status with the expected one but also highlight any exogenous critical factors that could undermine their success.

Additionally, courts consider it appropriate to implement an efficient system for managing commercial credits (and related technical procedures aimed at minimizing the emergence of credit losses or payment delays), along with periodic reporting on the overall status of credits and other useful information for making correct decisions concerning business continuity.

Finally, it is essential to monitor certain tools, such as the cash flow statement, and conduct a thorough analysis of

balance sheet items to promptly detect financial imbalances and keep the economic, financial, and asset situation of the business under control.

Adequate Structures in the Bank-Business Relationship

The issuance of the "*Guidelines on Loan and Monitoring*" ("**LOM**") by the European Banking Authority ("**EBA**"), effective from 30 June 2021, has significantly impacted the bank-business relationship. Previously, creditworthiness analysis was almost entirely focused on the analysis of the financial situation derived from the historical data of the business contained in financial statements, along with self-liquidating credit lines and the quality of the portfolio. Now, the EBA mandates a much broader and detailed evaluation process, focused on adequate risk control that integrates commercial elements and business context analysis.

From this perspective, the role of the Adequate Structures becomes even more central, considering that they become an essential parameter to monitor in the dynamics between banks and businesses, particularly during the creditworthiness evaluation phase.

With the issuance of these guidelines, banks are required to update and adapt their infrastructures and loan monitoring models by 30 June 2024, adopting new creditworthiness evaluation methods based on both backward-looking analyses (aimed at analyzing historical and actual business data) and forward-looking analyses (to evaluate future business data and information). A significant part of this is the evaluation of the "source of repayment capacity" from regular operations, which should result from a multi-year plan.

In essence, what becomes relevant is the financial outlook of the business and the sustainability of income and cash flows with respect to the financing required, with the consequence that businesses will no longer be able to use only the simple balance sheet as the main source of information for the bank.

Hence, it is crucial for businesses to establish Adequate Structures to provide banks, which are engaged in forward-looking analysis, with the tools to evaluate creditworthiness and monitor the loans granted to businesses.

The importance for the financing party to focus on the organizational structure is increased, with particular attention to the cash flow generated by core operations, as it is the primary source designated for loan repayment and thus represents a form of "guarantee" for the bank. Indeed, in light of the guidelines, real guarantees lose their centrality, becoming a sort of ancillary tool and loss mitigation measure in the event of the borrower's insolvency, but no longer sufficient to independently justify the granting of a loan.

Given what has been observed so far, and considering that the financial prospects of the business and the sustainability of cash flows in the medium/long term are now at the center of the bank-business relationship, it is reasonable to believe that only those entities with Adequate Structures capable of monitoring and somehow ensuring the solvency of the business will have greater access to credit and will be facilitated in their relationships with financial intermediaries.

Adequate Structures and Directors' Liability

It is also necessary to examine the liability profiles for directors who fail to implement adequate structures due to inertia and/or negligence.

Regarding the failure to implement Adequate Structures, recent courts decisions agree that it constitutes a serious irregularity, sufficient to entail the removal of the directors and their replacement with a judicial administrator pursuant to Article 2409 of the Italian Civil Code (Trib. Milan 29 February 2024 and Trib. Catania 8 February 2023).

Similar rulings have been made by the Court of Cagliari (19 January 2022) and the Court of Venice (29 November 2022), which hold that the absence of Adequate Structures is sufficient to trigger the remedies provided under Article 2409 of the Civil Code mentioned above.

It is also worth mentioning a recent decision of 6 February 2024, in which the Court of Catanzaro reiterated, in line with the now consolidated orientation outlined above, that the total lack of Adequate Structures constitutes a serious management irregularity. It further specified that this irregularity is even more severe in businesses not in a state of crisis, given the forward-looking rationale underlying the entire discipline on Adequate Structures. This rationale aims to prevent a solvent business from unexpectedly finding itself in a situation of economic-financial imbalance, a rationale that the Tribunal emphasized and reinforced with this ruling.

While there do not seem to be any doubts as to the liability of directors who have not provided the business with any Adequate Structure, the situation is more complex for directors who, though not inactive, have adopted structures that later proved inadequate in preventing a crisis. On this point, the Court of Rome (on 15 and 24 September 2020) ruled on the applicability of the "*business judgment rule*".

This rule enshrines the principle that management decisions made diligently by directors in the performance of their duties are not subject to any review of their merits. Consequently, while there is no question that the failure to adopt any organisational measures entails a liability of the administrative body, by applying the *business judgment rule* the adequacy must be assessed ex ante, according to criteria of reasonableness and diligence.

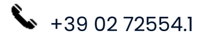
This ruling highlights even more the necessity for diligent directors to establish Adequate Structures. In the absence of such measures, there is a concrete risk of incurring liability for *mala gestio*.

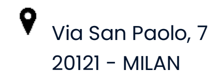
Conclusions

Although the subject matter discussed in this contribution is of recent implementation and evolving, the work of the legislator is sufficiently clear, allowing the identification of key points in both the CCII discipline and the recently implemented articles of the Civil Code. In this framework, the role of Adequate Structures is undeniably central. They are necessary not only to ensure the smooth operation of a solvent business but also to timely detect signs of crisis, thus preventing the risk of insolvency with all the related risks not only for directors but also for creditors, shareholders, and all stakeholders.

Paolo Barbanti Silva

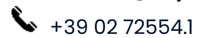
PARTNER

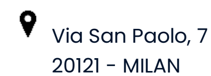




Enzo Fanelli

ASSOCIATE





MILAN
Via San Paolo, 7 - 20121 Milan, Italy
T. +39 02 72554.1 - F. +39 02 72554.400
milan@dejalex.com

ROME
Via Vincenzo Bellini, 24 - 00198 Rome, Italy
T. +39 06 809154.1 - F. +39 06 809154.44
rome@dejalex.com

BRUSSELS
Chaussée de La Hulpe 187 - 1170 Bruxelles, Belgique
T. +32 (0)26455670 - F. +32 (0)27420138
brussels@dejalex.com

MOSCOW
Potapovsky Lane, 5, build. 2, 4th floor, office 401/12/9 - 101000, Moscow, Russia
T. +7 495 792 54 92 - F. +7 495 792 54 93
moscow@dejalex.com